Operational Resiliency

A REGULATORY PERSPECTIVE – DRIVEN BY THE BANK OF ENGLAND’S DISCUSSION PAPER

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Executive Summary

- Background
  - Discussion Paper (DP)* issued by the Prudential Regulation Authority (PRA), the Financial Conduct Authority (FCA) and the Bank of England.
  - Focuses on the operational resilience** of the UK's Financial System and the individual firms and the Financial Mark Structures within it.
  - Specifically the Business Services offered by these institutions and not the underlying technologies and systems.
  - Seeks to address how continuity of service will be maintained regardless of the cause of disruption.
  - The DP commences a dialogue with the financial services industry on achieving a step change in the operational resilience of firms.
  - Output will be made available to the global regulatory community as there is no international framework supporting the regulation of operational resiliency of financial services.
- Benefits
  - Support firms in prioritizing investment and resource allocation.
  - Provide a clear scope for when firms want to test their own resilience.
  - Provide a focus for regulatory engagement.

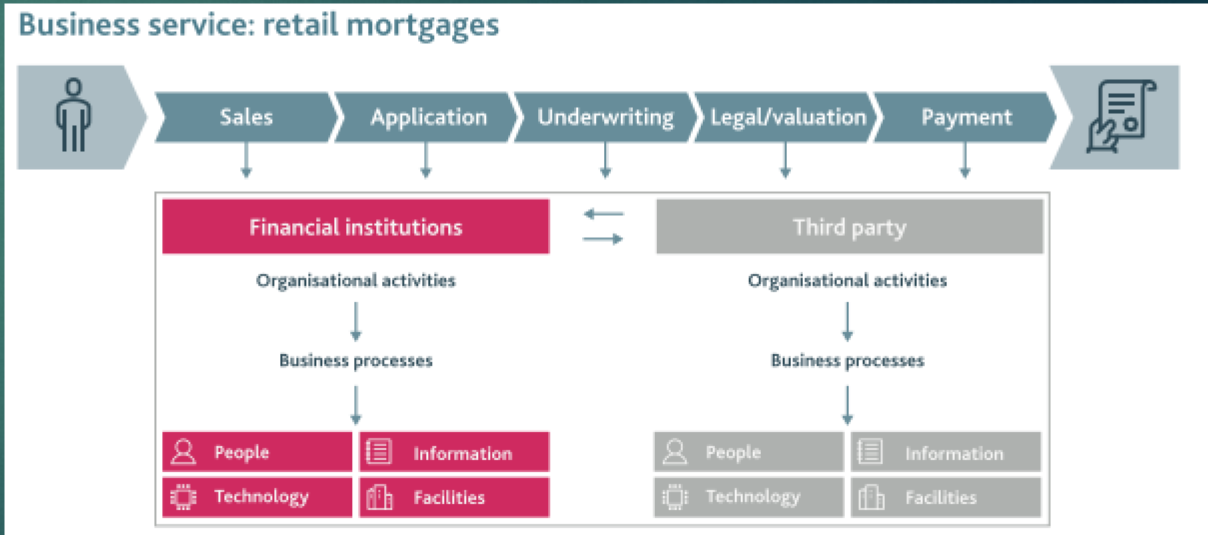
*Link the Bank of England Discussion Paper and KPMG commentary
** Refers to the ability of firms to prevent, respond to, recover and learn from operational disruptions. This pertains to their critical processes and irrespective of the type of disruption.

Operational Resiliency - Expectations

- It is implied that boards and senior management should assume that individual systems and processes that support business services will be disrupted, and increase the focus on back-up plans, responses and recovery options.
- Firms should set impact tolerances which quantify the amount of disruption that could be tolerated in the event of an incident, may be an efficient way to set standards for operational resilience.
- Consideration should be given to effective and timely communication with those impacted.
- The Regulators are reviewing their existing policies, including those on risk management, outsourcing, controls, communications, and business continuity plans, to ensure that these continue to be effective in light of market and technological developments.
- The Regulators are also reviewing their approach to their assessment of operational resilience matters including an increased focus on non-financial resources with a view to gaining assurance that the appropriate impact tolerances are set, monitored and tested.

Operational Resiliency – Focusing on Business Services

- A business services approach is an effective way to prioritize improvements to systems and processes.
- The Regulators are keen to understand which approaches to operational resilience have been the most successful to firms.
- Resiliency must be built into business services as the overarching assumption is that operational disruptions will arise.
- A firm that is operationally resilient will have the following in place:
  - An understanding of its critical business services.
  - An understanding and mapping of systems and processes supporting these business services (ditto dependencies and third parties). C.f. generic retail mortgage flow diagram.
  - How a failure of a process or system could impact the provision of the service.
  - Knowledge of which processes or systems could be substituted in a disruption so that business services can continue to be delivered.
  - Plans that have been tested, along with having communication plans (internal and external), escalation paths and known decision makers.



Operational Resiliency – Firm's Impact Tolerance 1/2

- The Regulators expect the Board and Senior Management to set impact tolerances for disruptions to its most important business services.
- Impact tolerance will describe the firm's tolerance for a disruption to a particular business service, assuming that disruption to the systems and processes supporting that service will occur. This can be expressed by reference to specific outcomes and metrics; like the number of customers impacted, maximum tolerable duration, measure of data integrity or volume of disruption.
- Firms should consider their commercial interests and the expectations of their Regulatory bodies to ensure there are no violations and meeting guidelines.
- The impact tolerance is different from a firm's risk appetite though it must be considered alongside current statements. It could be used in running businesses: to take decisions on investments, risk management, business continuity planning, and corporate structure.
- The impact tolerance once set, will be relevant to systems and processes supporting business services irrespective of location. This includes 3rd party service providers and jurisdictions.
- There has to be Senior Management oversight for activities outsourced to 3rd Parties (e.g. Cloud service providers). This needs to include identification and understanding of a firm's reliance on critical service providers.

Operational Resiliency – Firm’s Impact Tolerance 2/2

- The Regulators expect firms to adopt the following process to improve their operational resilience:

Identify	the most important business services and how much disruption could be tolerated in what circumstances
Map	the systems and processes that support these business services
Assess	how the failure of an individual system or process could impact the business service
Test	using scenarios and by learning from experience, that resilience meets the firm’s tolerance
Invest	in ability to respond and recover from disruptions through having appropriate systems, oversight and training
Communicate	timely information to internal stakeholders, supervisory authorities, customers, counterparties and other market participants

- By setting and articulating a clear impact tolerance at the business service level, it is possible to define alternative processing procedures that can be deployed in case of disruption to systems and processes in order to remain within impact tolerances
- The Regulators are looking into consolidating supervisory tools and assessment practices across firms:
  - Sector-wide work (including potential stress testing).
  - Assessment of how firms set and use their impact tolerances.
  - Analysis of systems and processes that support business services
  - Assurance that capabilities are in place to deliver operational resilience that are in compliance with existing rules and regulations

Conclusion

- The Regulators are driving resiliency of the financial markets through a Business Services approach.
- Firms are being surveyed on the currency of their operational resiliency.
- Firms are expected to set impact tolerances for their most critical business services which will feed their risk appetite.
- Firms should review and assess the currency of their business services and the infrastructure that supports them and design testing models to ascertain and refine the operational resiliency of these business services.

Appendix – The DP Questions 1/2

a) What are readers' views on the proposed focus on continuity of business services? Would a service rather than systems-based approach represent a significant change for firms and FMIs compared with existing practice? What other approaches could be considered?

b) Would encouraging firms and FMIs to consider their contribution to the vital services that the real economy demands change the way they manage operational resilience, and if so how? What additional costs would this incur?

c) How do boards and senior management currently prioritize their work on operational resilience?

d) What changes are firms and FMIs planning to make to strengthen operational resilience over the next few years? How involved are board members in the planning, implementation and embedding of any changes? What are the likely benefits and costs involved?

e) What are readers' views on the possibility of firms and FMIs being asked to set impact tolerances for their most important business services?

f) What approach and metrics do firms and FMIs currently use?

g) If these proposals would require some firms and FMIs to update part of their existing risk management framework, what would this involve?

Appendix – The DP Questions 2/2

h) What are readers’ views on producing an impact tolerance statement as described? What relevant operational resilience risk management documentation do firms and FMIs already produce, and how does this differ from impact tolerance statements?

i) What operational resilience tests or scenarios do firms and FMIs already consider and undertake for their own risk management purposes? What factors do firms and FMIs take into account when devising operational resilience tests or scenarios?

j) How do boards and senior management currently gain assurance over the operational resilience of their firm or FMI?

k) What are readers’ views on the proposed developments to the supervisory authorities’ approach